

Message Text

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TAGS: EFIN, IT
SUBJECT: ITALIAN MONETARY ECONOMIST'S VIEWS ON POSSIBLE NEW IMF
STAND-BY PROGRAM

1. SUMMARY: PROF. MARIO MONTI, ACADEMIC ECONOMIST AND
CONSULTANT TO BANCA COMMERCIALE ITALIANA, BELIEVES THAT IN ANY
NEW STAND-BY LOAN PROGRAM FOR ITALY, THE IMF SHOULD
REFORMULATE THE TOTAL DOMESTIC CREDIT CEILING OBJECTIVE AND PAY
MORE ATTENTION TO THE MONEY SUPPLY. END SUMMARY.

2. DURING RECENT TRIP TO MILAN, ASSISTANT TREASURY
ATTACHE AND TREASURY DESK OFFICER FOR ITALY HAD OPPORTUNITY
TO OBTAIN VIEWS OF PROF. MARIO MONTI, ON RECENT MONETARY
DEVELOPMENTS AND POSSIBLE NEW IMF STAND-BY FOR ITALY. MONTI SAID
THAT THE TOTAL DOMESTIC CREDIT CEILING APPROACH OF THE IMF HAD
WORKED PRETTY WELL TO-DATE IN THE CASE OF ITALY, BUT HE HOPED
THAT THE IMF WOULD BEGIN PAYING MORE ATTENTION TO THE MONEY
SUPPLY. ALTHOUGH MONTI GAVE THE AUTHORITIES CREDIT FOR
STABILIZING THE RATE OF GROWTH OF THE MONEY SUPPLY AT 20-22
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PERCENT A YEAR, SUCH A RATE WAS STILL HIGH, AND HE THOUGHT
THAT THEY SHOULD BE CONCERNED ABOUT THE GROWING LIQUIDITY IN
THE ECONOMY. AS A SHARE OF NOMINAL GDP, THE STOCK OF MONEY WAS
HIGH AND RISING. THE DEGREE OF LIQUIDITY OF THE HOUSEHOLD
SECTOR WAS PARTICULARLY ELEVATED.

3. MONTI THOUGHT THERE WOULD BE SUBSTANTIAL NET BENEFITS

IN TERMS OF MORE EFFICIENT RESOURCE ALLOCATION IF THE ITALIAN MONETARY AUTHORITIES WOULD BEGIN TO TRY TO CONTROL THE LIABILITY SIDE OF BANKS' BALANCE SHEETS AND TO ALLOW THEM MORE FREEDOM ON THE ASSET SIDE. AT PRESENT, PERHAPS THE MOST IMPORTANT MONETARY POLICY INSTRUMENTS ARE THE CEILINGS ON LIRA LOANS TO COMMERCIAL CUSTOMERS AND THE FLOORS ON BANKS' HOLDINGS OF FIXED-INTEREST SECURITIES. AT THE SAME TIME, BANKS ARE COMPETING FOR ADDITIONAL DEPOSITS AND INDIVIDUAL SAVERS HOLD AN EVER-INCREASING PERCENTAGE OF THEIR WEALTH IN THE FORM OF BANK DEPOSITS. MONTI THINKS THE BANK OF ITALY SHOULD MOVE TO ENCOURAGE SAVERS TO SHIFT TO LONGER-TERM ASSETS BY REQUIRING BANKS TO OFFER SAVERS MORE OF A PREMIUM FOR GIVING UP SOME LIQUIDITY. (DEMAND DEPOSITS NOW PAY ABOUT TEN PERCENT A YEAR, WHICH IS ONLY SLIGHTLY LESS THAN THE YELD ON 3-MONTH TREASURY BILLS.

MEASURES HE SUGGESTS THAT MIGHT DISCOURAGE BANKS FROM A "MAXIMIZING DEPOSITS" INCLUDE (1) MARGINAL, IN ADDITIONAL TO THE PRESENT PROPORTIONAL, RESERVE REQUIREMENTS, (2) MAKING PROGRESSIVE THE FLOORS ON SECURITY HOLDINGS, WHICH ARE TIED TO THE LEVEL OF DEPOSITS, AND (3) MORE SCOPE FOR BANKS TO EARN MONEY THROUGH COMMISSIONS ON TREASURY BILL SALES TO THE PUBLIC. MONTI ACKNOWLEDGES THAT GREAT CARE SHOULD BE TAKEN NOT TO REDUCE CURRENT OVERALL INCENTIVES TO HOLD FINANCIAL ASSETS SINCE THAT COULD RESULT IN A SUDDEN AND DISASTROUS INCREASE IN VELOCITY, WHICH IS AT PRESENT QUITE LOW AND DECLINING.

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4. MONTI ALSO SAID THAT IF THE IMF SHOULD SEEK TO IMPOSE ANOTHER DOMESTIC CREDIT CEILING ON ITALY, IT SHOULD CONSIDER FORMULATING IT IN TERMS OF A RANGE OF QUARTERLY PERCENTAGE INCREASES AND WITH A ROLLING BASE, SIMILAR TO THE FEDERAL RESERVE'S MONETARY TARGETS. IN THIS WAY SUCH CREDIT EXPANSION GOALS COULD HAVE SALUTORY ANNOUNCEMENT EFFECTS IN THE MARKET, WITHOUT NEED OF COMMENT OR ANALYSIS. AS IT IS, GIVING ONLY THE ABSOLUTE AMOUNT, IT IS IMPOSSIBLE TO SAY WHETHER THE GOAL IS RESTRICTIVE, EXPANSIONARY, OR NEUTRAL. ROLLING BASES WOULD ALSO MAKE POSSIBLE THE MONITORING OF PERFORMANCE WITHOUT DAMAGING THE CREDIBILITY OF BOTH THE IMF AND THE ITALIAN GOVERNMENT AS WAS THE CASE DURING THE CURRENT STABILIZATION PROGRAM, WHEN THE IMF HAS APPEARED TO RATIFY AFTER CONSIDERABLE DELAY LARGE DEISCREPANCIES BETWEEN OBJECTIVES AND PERFORMANCE.

5. COMMENT: PROF. MONTI IS ONE OF THE FEW ITALIAN ECONOMISTS THAT CLOSELY FOLLOW MONETARY DEVELOPMENTS. HE STATED AT LEAST SOME OF THE VIEWS CITED ABOVE TO IMF DIRECTOR ALAN WHITTOME DURING A DINNER HOSTED BY WHITTOME FOR PRIVATE ECONOMISTS DURING HIS RECENT VISIT TO ROME (ROME 8914)AND IN RESPONSE TO WHITTOME'S QUESTION, "ARE THE MONETARY AGGREGATES GETTING

OUT OF CONTROL?" ALTHOUGH THE BANK OF ITALY LOOKS AT MONETARY
BASE (I.E., CURRENCY IN CIRCULATION AND BANKS' RESERVES WITH
THE ENTRAL BANK), IT MAINLY FOCUSES ON TOTAL DOMESTIC CREDIT
AS A TARGET VARIABLE. THAT IS, IT SEEKS MAINLY TO RESTRICT
THE USE OF BASE MONEY IN CREDIT CREATION OR TO ALTER THE
DISTRIBUTION OF CREDIT AMONG ALTERNATIVE ASSETS OF BANKS.
THE BANK OF ITALY PAYS RELATIVELY LITTLE ATTENTION TO MONEY
AGGREGATES, BELIEVING THAT IT MAKES LITTLE DIFFERENCE
WHETHER IT IS MONEY OR CREDIT THAT IS THE PRINCIPLE TARGET
VARIABLE. PROF. MONTI MAY BE RIGHT, HOWEVER, IN BELIEVING THAT
ROOM FOR MANOUVER ON THE CREDIT SIDE IS EVER DECREASING.
THE MAJOR SHARE OF THE ASSETS OF ITALIAN COMMERCIAL BANKS ARE
SUBJECT TO BANK OF ITALY ADMINISTERED CONSTRAINTS, SUCH AS
RESERVE REQUIREMENTS, CEILINGS ON LOANS, AND FLOORS ON SECURITY
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HOLDINGS. MONTI BELIEVES THAT BY STABILIZING THE MONEY
AGGREGATES, THE BANK OF ITALY COULD ACHIEVE BOTH MORE STABILITY
FOR THE PRIVATE SECTOR AND LOWER INTEREST RATES.GARDNER

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